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McGINNIS LOCHRIDGE

Producer's Edge

TEXAS OIL AND GAS LAW BULLETIN

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The McGinnis Lochridge Oil and Gas Practice Group publishes the *Producer's Edge* with the purpose of keeping our valued clients and contacts in the oil and gas industry updated and informed regarding interesting Texas case law and regulatory developments, as well as providing insightful articles relevant to the oil and gas community. In this print and digital publication, we also routinely welcome various other practice groups to share guest articles surveying other areas of the law important to the oil and gas industry.

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MCGINNIS LOCHRIDGE

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- Seven Attorneys recognized by Chambers USA 2022
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- Two McGinnis Lochridge attorneys selected to Benchmark Litigation's 2022 40 & Under Hot List: Austin Brister, Chris Halgren
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- Ten McGinnis Lochridge Attorneys Recognized as 2022 Super Lawyers
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- Austin W. Brister elected as Council to the Energy Law Section of the Houston Bar Association (2022- 2023)
- Jonathan Baughman selected as Course Director for the 41st Annual Advanced Oil & Gas Resources Course, September 7-8, 2023, Houston, Texas
- Jonathan Baughman serves as the Chair-Elect for the Oil, Gas & Energy Resources Law Section of the State Bar of Texas
- Jonathan Baughman serves as Chair of the Louisiana Mineral Law Institute Advisory Council
- Jonathan Baughman selected Co-Chair for 2023 Foundation for Natural Resources and Energy Law, Special Institute on the Law of Permian Basin, Santa Fe, New Mexico
- Austin W. Brister elected as Council to the Energy Law Section of the Houston Bar Association (2022- 2023)
- Austin W. Brister selected Co-Chair, Oil and Gas and Landman Sections, 2022 Annual Institute, Foundation for Natural Resources and Energy Law, Vail, Colorado
- Austin W. Brister, Selected as Trustee-at-Large and Programs Committee, 2022 and 2023, Foundation for Natural Resources and Energy Law
- Austin Brister, Seth Isgur, and Logan Jones, "Recent Texas Oil and Gas Cases," in three consecutive issues of the Oil, Gas & Energy Resources Law Section, State Bar of Texas, 2022-2023
- Derrick Price, "Construing Retained Acreage and Related Clauses," 48th Annual Ernest E. Smith Oil, Gas and Mineral Law Institute
- Derrick Price and Austin Brister, "Force Majeure During and After the COVID Pandemic," 47th Annual Ernest E. Smith. Oil, Gas and Mineral Law Institute
- Austin Brister and Alejandra Salas, "Inherent Surface Conflicts Between Oil and Gas and Renewables," 49th Annual Ernest E. Smith Oil, Gas and Mineral Law Institute

SCOTX Adopts New Rebuttable Presumption Governing Double-Fraction Deed Cases

Van Dyke v. Navigator Grp., 2023 Tex. LEXIS 144 (Tex. 2023)

By: Austin W. Brister

In this landmark case, the Texas Supreme Court reaffirmed its recognition of the so-called "estate misconception theory," and created a new rebuttable presumption governing so-called "double fraction" deed interpretation cases. Under this new rebuttable presumption, any time an "antiquated" mineral instrument uses the term "1/8" in a double fraction, there is a rebuttable presumption that "1/8" was used as a term of art that refers to the entire mineral estate, and not merely to a mathematical 1/8th. The case is also notable in its discussion of what might rebut that presumption, and its discussion of the presumed-grant doctrine.

The case involves a 1924 deed, under which the "Mulkeys" conveyed to "White and Tom" an interest in their land, with the following reservation:

> It is understood and agreed that one-half of one-eighth of all minerals and mineral rights in said land are reserved in grantors... and are not conveyed herein.

The Court held that this language did not use the double fractions in a rote mathematical sense, where they would be multiplied together resulting in a 1/16th interest. Instead, the Court held that this language objectively referred to "1/8" as a synonym for the entire mineral estate. The Texas Supreme Court provided three primary rationales that, in its view, supported the adoption of this new presumption.

First, the Court emphasized that the proper focus is on determining the original meaning of the text when it was drafted in 1924, not the meaning the text would have if written today. The Court also indicated that the proper analysis is an *objective* inquiry confined to an interpretation of the four corners of the text, not on a *subjective* inquiry into extrinsic evidence of what the parties may have "secretly or unusually" intended. The Court approved the use of dictionaries in this endeavor, explaining that "they convey objective and generally available–not subjective or bespoke–guides to meaning."

Next, the Court relied on the so-called "estate misconception theory" and the "historical use of 1/8 as the standard royalty" as two "historical features" that, in the Court's view, provide "objective indication of what parties meant by using 1/8 within a double fraction."

According to the Court, the so-called "estate misconception theory" is a theory that "reflects the prevalent (but, as it turns out, mistaken) belief that, in entering into an oil-and-gas lease, a lessor retained only a 1/8 interest in the minerals, rather than the entire mineral estate in fee simple determinable with the possibility of reverter of the entire estate." According to the Court, "for many years, lessors would refer to what they *thought* reflected their entire interest in the 'mineral estate' with a simple term they understood to convey the same message: '1/8.'" The Court quoted a popular commentator on this subject, with approval, saying "the very use of 1/8 in a double fraction 'should be considered patent evidence that the parties were functioning under the estate misconception'" and reasoning "there is 'little explanation' for the use of double fractions to express a fixed interest absent a misunderstanding about the grantor's retained ownership interest or use of 1/8 as a proxy for the customary royalty."

The Court also relied on the so-called "legacy of the 1/8 royalty," or "historical standardization" of a 1/8 royalty in historical oil and gas leases. According to the Court, lease royalty rates were so standardized at 1/8 for a period of time that "parties mistakenly assum[ed] the landowner's royalty would always be 1/8." In the Court's view, there is "no doubt" that this mistaken belief "influenced the language used to describe the quantum of royalty in conveyances of a certain vintage."

The Court concluded that those two historical principles, working in tandem, "provide objective indications about what the parties to this deed meant by deploying a double fraction. At that time, the fraction 1/8 had various meanings that linked to the landowner's conception of the entirety of the estate." In the Court's view, based on those two theories, there is a "now-familiar observation that, at the time the parties executed this deed, '1/8' was widely used as a term of art to refer to the total mineral estate."

Rather than issue a narrow holding limited to the specific facts of this case, the Court adopted a broad "rebuttable presumption," which it described as follows:

> Antiquated instruments that use 1/8 within a double fraction raise a presumption that 1/8 was used as a term of art to refer to the "mineral estate." That presumption is readily rebuttable, however. If the text itself has provisions – whether express or structural—illustrating that a double fraction was in fact used as nothing more than a double fraction, the presumption will be rebutted.

However, the Court rejected a "bright-line rule" that the presumption applies to all "antiquated" double-fraction deeds, instead holding that "a full textual analysis of an instrument" is required. On that note, the Court noted the following as to rebutting the presumption:

> [C]ourts should be ready to find not just confirmation but contradictions of [this] presumption. A rebuttal could be established by express language, distinct provisions that could not be harmonized if 1/8 is given the term-of-art usage (the mirror image of *Hysaw*), or even the repeated use of fractions *other* than 1/8 in ways that reflect that an arithmetical expression should be given to all fractions within the instrument. [...] The key point is that there must be some textually demonstrable basis to rebut the presumption.

On the other hand, the Court indicated there could be a middle ground, resulting in ambiguity. As the Court described:

> an instrument may have enough textual evidence to drain confidence in the presumption yet insufficient evidence for a court to conclude that a reasonable reader at the time would have understood the instrument to require mere multiplication. In such a case, and if our ordinary rules of construction are incapable of generating a single answer, then our case law involving inescapable ambiguity – including the authorized but reluctant recourse to extrinsic evidence – provides the next step. When that happens, a factfinder may be needed to finally resolve the text's meaning.

The Court then turned to the second justification for its holding: the presumed-grant doctrine. After the 1924 deed, for approximately 90 years, the parties, their assignees and various third parties engaged in numerous transactions that repeatedly reflected that each side of the original conveyance owned an equal 1/2 interest in the minerals. That included further conveyances, leases, division orders, probate inventories, and other recorded documents.

According to the Court, there were no exceptions to that consistent treatment until 2012 when an oil and gas company drilled a well and then began paying royalties and the White heirs filed suit.

The Court held that, under these facts, "the record conclusively establishes that [the Mulkey] parties acquired the other 7/16 interest through the presumed-grant doctrine."

The Court held that the presumed-grant doctrine requires three elements: (1) a long-asserted and open claim, adverse to that of the apparent owner; (2) nonclaim by the apparent owner; and (3) acquiescence by the apparent owner in the adverse claim. The Court rejected a fourth element that was described by the appellate court: a gap in the title. According to the Court, "[s]atisfying the doctrine is properly difficult…."

The Court held that these elements were conclusively established based on the parties' ninety-year history of "repeatedly acting in reliance on each having a 1/2 mineral interest."

Interestingly, the Court indicated that its presumed-grant analysis required analysis of "extrinsic evidence [that] is not probative in the [rebuttable presumption analysis] because it would go beyond the text." On the other hand, the Court also indicated in a footnote that if the presumed-grant doctrine were "clearly implicated, a court could dispense with the deed-construction analysis," which could ultimately "cut either way – in favor of or contrary to the party invoking the double-fraction presumption."

About the Author

Austin Brister *is a partner in our Oil and Gas group. Before lawsuits are filed, Austin helps oil and gas companies analyze complicated issues, and strives to develop creative and practical business solutions. But, when necessary, Austin works hard to implement aggressive, goal-focused strategies in the courthouse. Austin frequently assists clients in resolving problems involving title disputes, injunctive relief, joint operating agreements, accounting issues, royalty disputes, lease termination disputes, surface use and trespass issues, purchase and sale issues, lease saving operations, and a host of other oil and gas issues..*

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Three Tips for Handling Evasive Discovery Objections

By: Marcus V. Eason

Managing discovery objections can often be a challenge in litigation, especially when it is apparent that your opponent's objections are made for purposes of delay or concealment. Here are three tips to effectively handle such objections and keep your case moving forward.

Persistence

When opposing counsel objects to discovery requests, the first tip is persistence. Do not allow too much time to pass before addressing the issue with them. It is far better to address any discovery dispute when the topic is fresh in the parties' minds. Further, prompt action can signal to your opponent that you take the discovery requests, and your opponent's obligations seriously. Delaying in bringing any issue to the forefront will not serve you.

Resist the Urge to Respond in Kind

Resist responding in-kind when the time comes to serve your own responses. Court's typically disfavor petty discovery disputes, and if you truly believe your opponent's objections are improper, no problems are solved by following your opponent's footsteps in serving evasive responses. Reverting to a combative style may not only further complicate the discovery process, but it may also unnecessarily escalate costs for your client.

Avoid a "Tit-for-Tat" Letter Writing Campaign

Finally, resist the temptation to engage in a back-and-forth letter-writing campaign. While every court that I practice before requires the parties to confer prior to the filing of a discovery motion, it is possible to do so in a manner that is productive, respectful, and professional.

First, it is often best to begin with a concise letter outlining your concerns regarding the propriety of the discovery objections at hand. Offer to set a time for a conference call to further discuss and work through the discovery objections. During the "meet and confer" process, it is important to keep an open mind. There have been many times in my career that requests I believed were proper could be viewed differently through the lens of the responding party.

After it has become apparent that you have explored reasonable options for compromise or resolution without the court, consider filing a motion. Your motion should be succinct and to the point, and outline the relevant responses and objections for the court's consideration.

About the Author

Marcus Eason *is a partner in our Houston office. Marcus specializes in complex commercial, business, and partnership disputes including disputes over purchase and sale agreements, business fraud and theft, and lien disputes.*

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SCOTX Holds Unique Royalty Language Created "Proceeds Plus" Royalty Base

Devon Energy Prod. Co., L.P. v. Sheppard, No. 20-0904 2023 Tex. LEXIS 223 (Tex. Mar. 10, 2023)

By: Austin W. Brister

In this case, the Texas Supreme Court reviewed a "bespoke" oil and gas lease, and held that its "unique," "unusual," and "broad lease language" provided for a "proceeds plus" royalty base. The Court indicated that this broad and unusual language unambiguously called for a royalty base that may exceed the lessee's gross proceeds, because it "plainly requires the producers to pay royalties on the gross proceeds of the sale *plus* sums identified in the producers' sales contracts as accounting for actual or anticipated postproduction costs, even if such expenses are incurred only by the buyer after or downstream from the point of sale."

The Court generally noted that, though leases operate against a backdrop of jurisprudence regarding "usual" rules, "we have consistently recognized that parties are free to make their own bargains." One "usual" rule is that royalties are free of production costs, but not free of postproduction costs. However, "[l]andowners and producers can 'agree on what royalty is due, the basis on which it is to be calculated, and how expenses are to be allocated.'"

The unique leases at issue in this case included a gas royalty provision on "gross proceeds realized from the sale, free of all costs and expenses, to the first non-affiliated third party purchaser under a bona fide arms length sale or contract."

The leases also contained two "more unconventional" provisions, including a Paragraph 3(c) reading as follows:

> (c) If any disposition, contract or sale of oil or gas shall include any reduction or charge for the expenses or costs of production, treatment, transportation, manufacturing, process[ing] or marketing of the oil or gas, then such deduction, expense or cost shall be added to . . . gross proceeds so that Lessor's royalty shall never be chargeable directly or indirectly with any costs or expenses other than its pro rata share of severance or production taxes.

The lease also contained a unique Addendum L, which read as follows:

> L. ROYALTY FREE OF COSTS:
>
> Payments of royalty under the terms of this lease shall never bear or be charged with, either directly or indirectly, any part of the costs or expenses of production, gathering, dehydration, compression, transportation, manufacturing, processing, treating, post-production expenses, marketing or otherwise making the oil or gas ready for sale or use, nor any costs of construction, operation or depreciation of any plant or other facilities for processing or treating said oil or gas. Anything to the contrary herein notwithstanding, it is expressly provided that the terms of this paragraph shall be controlling over the provisions of Paragraph 312 of

> this lease to the contrary and this paragraph shall not be treated as surplusage despite the holding in the cases styled "*Heritage Resources, Inc. v. NationsBank*", 939 S.W.2d 118 (Tex. 1996) and "*Judice v. Mewbourne Oil Co.*", 939 S.W.2d [133,] 135-36 (Tex. 1996).

The lessees sold the oil and gas production to unaffiliated third parties at various downstream sales points. The lessees then paid royalties on the basis of their gross proceeds, without any deduction of expenses the lessee's incurred to ready the production for sale. The lessees did not, however, include any post-sale costs incurred by the third-party buyers after the point of sale.

The lessors contended that this was a breach of the unique royalty provisions. The lessors contended that the unique leases require the lessee to "add to" "gross proceeds" any "reductions or charges" in the lessee's sales contracts, so that the landowners' royalty is never burdened by postproduction costs, not even "indirectly." The lessors contended that the language was written to unburden the royalty interests from postproduction costs, irrespective of the lessee's unilateral choices about where and in what condition to sell production, to the extent that "the royalty calculation [is made] consistent no matter where the producers choose to sell production."

The lessees, on the other hand, argued that these unique provisions were "mere surplusage that emphasizes the cost-free nature of a 'gross proceeds' royalty by requiring them to 'add back' only pre-sale postproduction costs that may have diminished the sales price." The lessees characterized the lessor's interpretation as "untenably contrary to the industry's expectation that a royalty free of postproduction costs means only those costs incurred up to the point of sale."

The Court rejected the lessee's construction, reasoning that "[a] reasonable person would not read [these] words" to "construe 'added to…gross proceeds' as the equivalent of 'gross proceeds.'" Instead, in the Court's view, the unique provisions in these leases "plainly require certain sums to be 'added to' gross proceeds." The Court indicated that "parties to a mineral lease could unquestionably make [an] agreement" to "require[e] producers to pay royalty on postproduction costs incurred downstream from the point of sale." The Court reasoned that it would not be unreasonable for Texas lessors to negotiate lease terms that provide something similar to the "marketable product" rule in other jurisdictions – where a producer is required to pay royalties on the value of the product in a commercially usable condition and in a commercial marketplace, regardless of where and in what condition the product is actually sold.

Ultimately, the Court held that the "inescapably broad language" in these unique provisions is "clear" in that "[i]t requires 'any reduction or charge' for postproduction costs that have been included in the producer's disposition of production to be 'added to' gross proceeds so that the landowners' royalty 'never' bears those costs even 'indirectly.'" The Court went on to say, "Paragraph 3(c) is not textually constrained to the expenses incurred by the seller or prior to the point of sale." Further, "Paragraph 3(c) unambiguously contemplates royalty payable on an amount that may exceed the consideration accruing to the producers."

The Court agreed with the lessees that courts construe commonly used terms in a uniform and predictable way in order to assure continuity and predictability in oil and gas law. "But there is nothing common, usual, or standard about the language in Paragraph 3(c), which is quite clear in expressing the intent to deviate from the usual expectations regarding the allocation of postproduction costs" in two ways: (1) first by requiring royalties on gross proceeds, which departs from the general rule that a lessor bears a proportionate share of post-production costs, and (2) "by requiring an *addition* to gross proceeds for the stated purpose of freeing the landowners' royalty from 'any costs or expenses other than its pro rata share of severance or production taxes."

Finally, the Court turned to the lessee's contention that, even if some post-sale postproduction costs must be included in the royalty base, expenses for "transportation and fractionation" (or "T&F") are not among them. The Court disagreed, reasoning that T&F is a term of art referring to transporting raw gas downstream for fractionation to separate raw gas into purer products. Because the unique royalty provisions in these leases expressly included expenditures to "process" production, that included "T&F" fees.

About the Author

Austin Brister *is a partner in our Houston office. Austin represents small and mid-size oil and gas companies in a range of business disputes. Austin strives to help clients find creative and practical business solutions. When necessary, Austin works hard to implement aggressive, goal-focused strategies in the courthouse.For more information, contact Austin at 713-615-8523 or* abrister@mcginnislaw.com.

Condemnation Update

Miles v. Texas Central Railroad, 647 S.W.3d 613 (Tex. 2022)

Hlavinka v. HSC Pipeline, No. 20-0567, 2022 WL 1696443 (Tex. May 27, 2022), reh'g denied (Sept. 2, 2022)

By: Seth M. Isgur

Texas Supreme Court Helps Clear the Path for High-Speed Railway

In *Miles v. Texas Central Railroad*, the Texas Supreme Court addressed a topic that has polarized the State: the proposed high-speed railway connecting Houston and Dallas. 647 S.W.3d 613 (Tex. 2022). Opponents of the project will be disappointed by the outcome.

In particular, the Court examined whether the developers of the proposed high-speed railway have the power of eminent domain. The issue boiled down to whether statutes granting the power of eminent domain to a "railroad company" and/or "electric railway" apply to the high-speed rail project. See Tex. Transp. Code § 112.002 (granting the power of eminent domain to a "railroad company"); *id.* at § 131.02 (granting the power of eminent domain for "lines of electric railway between municipalities").

The lower courts reached opposite conclusions on the issue. The Leon County District Court held that neither statute applied and that the developers therefore lacked the power of eminent domain. The Corpus Christi-Edinburgh Court of Appeals, however, held that both statutes applied and that the developers had the power of eminent domain.

After initially denying the landowner's petition for review, the Texas Supreme Court (influenced, perhaps, by the substantial public interest and filing of numerous amici briefs) ultimately accepted the case. In a 5-3 opinion, the Court sided with the developers in holding that they have the power of eminent domain as an electric railway under Section 131.02 of the Transportation Code. Having determined that the developers have the power of eminent domain under Section 131.02, the Court had no reason to examine whether the developers might also have the power of eminent domain as a railroad company under Section 112.002.

In reaching this conclusion, the Texas Supreme Court emphasized that it was addressing an issue of statutory construction and not expressing any opinion on the high-speed rail project in general. But as a practical matter, the Court eliminated a major—and likely fatal—obstacle for the project in allowing the developers to condemn the necessary land for the project to move forward.

Texas Supreme Court Clarifies the Requirements for Establishing Common Carrier Status and Endorses the Pipeline-Corridor Valuation Theory

The Texas Supreme Court also addressed several important eminent domain issues in *Hlavinka v. HSC Pipeline*, No. 20-0567, 2022 WL

1696443 (Tex. May 27, 2022), reh'g denied (Sept. 2, 2022).

HSC Pipeline filed suit to condemn an easement out of the Hlavinkas' property in Brazoria County, for the purpose of constructing a pipeline to transport polymer grade propylene ("PGP"). The Hlavinkas initially raised two challenges to HSC Pipeline's use of eminent domain. First, the Hlavinkas argued that Texas law does not support the use of eminent domain for the transportation of PGP. Second, the Hlavinkas argued that HSC Pipeline had not established that the pipeline satisfied the "public use" requirements for a common carrier pipeline.

The state district court rejected both arguments and the case went to trial. During trial, the court excluded the Hlavinkas' testimony regarding amounts that two other pipeline companies had recently paid to acquire easements across the property.

The Hlavinkas appealed. The Houston [1st District] Court of Appeals agreed with the trial court that eminent domain could be used for a PGP pipeline. The Court of Appeals, however, disagreed with the trial court in holding that: (1) HSC Pipeline had not demonstrated as a matter of law that the pipeline satisfied the "public use" requirements for a common carrier; and (2) the Hlavinkas' testimony regarding amounts paid by other pipeline companies to acquire easements should have been admitted at trial.

Following an appeal from both HSC Pipeline and the Hlavinkas, the Texas Supreme Court issued a unanimous opinion clarifying three important issues that the case presented. First, the Supreme Court held that Section 2.105 of the Business Organizations Code bestows the power of eminent domain for common carrier pipelines carrying "oil products," and that PGP qualifies as an "oil product." Next, the Supreme Court held that—because the evidence demonstrated that HSC Pipeline had a contract to transport the PGP for at least one unaffiliated customer—the lower courts should have decided, as a matter of law, that the pipeline served a public use. Third and last, the Court agreed with the Court of Appeals in holding that the Hlavinkas' testimony regarding amounts paid by other pipelines to acquire easements on the property should have been admitted at trial.

All told, the Supreme Court's opinion is a mixed bag for landowners and condemnors. The Court's first two conclusions were favorable to condemnors in clarifying that "oil products" (as used in Section 2.105 of the Business Organizations Code) is broadly interpreted and that a single contract with an unaffiliated customer satisfies the evidentiary requirements for establishing that a pipeline serves a public use. These conclusions should give condemnors more confidence and certainty in exercising the power of eminent domain. The Court's last conclusion, however, breathes new life into the pipeline-corridor valuation theory and may make it more expensive for condemnors to acquire easements out of properties that are already encumbered with multiple pipelines.

About the Author

Seth Isgur *is a partner in our Houston office and a member of the Litigation Practice Group. In his eminent domain practice, Seth typically represents condemnors—including oil/gas pipeline companies and government entities—and has first chaired at least 50 special commissioners hearings across the State of Texas. For more information, contact Seth at 713-615-8545 or* ***sisgur@mcginnislaw.com.***

NEW ATTORNEY ANNOUNCEMENT

McGinnis Lochridge Welcomes

Three New Attorneys

Austin Jones

Alejandra Salas

Elias Yazbeck

We are pleased to welcome three new lawyers in our Austin and Houston offices: Austin Jones, Alejandra Salas, and Elias Yazbeck.

Austin Jones's practice focuses on a wide array of general litigation and commercial litigation matters, including significant experience in oil and gas matters. He assisted clients in resolving disputes in in state and federal courts, state and federal agencies, and arbitration.

Alejandra's main practice is litigation with a focus on the oil and gas industry. Prior to joining the Firm, Alejandra served as a judicial law clerk to the Honorable David Counts of the United States District Court for the Western District of Texas, Midland/Odessa and Pecos Divisions. During this time, Alejandra managed half of the civil and criminal dockets, prepared orders on wide-ranging issues, and assisted in preparation for evidentiary hearings, jury selections, and trials. As a law clerk, Alejandra gained practical familiarity with the litigation process and a unique understanding of the judicial system.

Elias M. Yazbeck joins the Firm's Houston office. Elias' practice involves a wide-range of commercial litigation matters in federal and state courts, with a focus on the oil & gas/energy industries and finance/bankruptcy practice. Prior to joining the Firm, Elias served as a judicial intern for The Honorable Judge Marvin Isgur, Federal Bankruptcy Judge for the Southern District of Texas, and The Honorable Judge Zack Hawthorn, Federal Magistrate Judge for the Eastern District of Texas. Prior to practicing law, Elias worked as a financial analyst for a major commercial real estate developer.

"We are pleased to welcome these talented new colleagues to the firm," said Doug Dodds, Managing Partner. "Their arrival adds significantly to what we can offer our energy clients."

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Assignment's Definition of "Assets" Held Broad Enough to Include Lease Not Described

Hogg v. Blackbeard Operating, 656 S.W.3d 671, 673 (Tex. App.—El Paso 2022, no pet. h.)

By: Austin W. Brister and Logan Jones

A winning strategy in an assignment interpretation case often involves finding a persuasive harmonization between the form of assignment and the exhibit containing property descriptions. Cases from recent years show disputes can arise (and do) over whether a detailed exhibit is intended to be descriptive, or intended to limit the scope of interests conveyed. But is less always more? Probably not, as a recent El Paso Court of Appeals case demonstrates that the omission of a lease from an exhibit can lead to a dispute and a lawsuit. At least in this recent case, however, the scope of the assignment form was enough to rescue the omission of a lease from the exhibit.

In this case, the court held that an assignment, which assigned "Lands," among other defined "Assets," effectively assigned oil and gas leases expressly described in the assignment, as well as other leases covering the same lands which were not described in the assignment.

This case involved two oil and gas leases executed by the Hoggs, covering lands in Winkler County, Texas. One lease (the 1994 Lease), covered the "SE/4 of Section 24, Block B-10, Public School Lands." Another lease (the 1998 Lease), covered a portion of that same acreage, being "the SE/4 of the SE/4 and the N/2 of the SE/4 of Section 24, Block B-10, Public School Lands."

In 2005, the lessee executed an assignment of a number of oil and gas leases in favor of Standolind Oil and Gas Corporation. Notably, an exhibit to that assignment specifically described several oil and gas leases being assigned. That exhibit included a description of the 1994 Lease from the Hoggs, but it did not describe the 1998 Lease from the Hoggs.

The assignor argued that, because the 1998 Lease was not described in the exhibit, that meant it was not assigned under the 2005 assignment.

The appellate court held that the assignment was sufficiently broad to include the 1998 Lease, even though it was not specifically described in the exhibit. The court reasoned that the assignment assigned all interests in specific identified leases (which it defined as the "Leases"), but it also contained even broader language, assigning all of the assignor's interest in "the land conveyed by the Leases" and lands pooled therewith (which it defined as the "Lands"). In the appellate court's view, because the assignment described the 1994 Lease, that meant the assignment covered all interests in the 160 acres covered by that lease. The 1998 Lease covered 120 of those same acres. Therefore, according to the appellate court, by its plain terms, the assignment covered all of the assignor's interest in the 120 acres covered by the 1998 Lease.

In addition, another subparagraph assigned "[a]ll leasehold interest in or to any pools or units that include any Lands…including, but not limited to, those pools or units shown on Exhibit A-1." That exhibit identified a well which the parties agreed was drilled under the 1998 Lease. According to the appellate court, because that subsection included "all leasehold interest" in that identified well, the assignment transferred all of the assignor's interest in that lease and well.

The assignor also argued that the assignment does not hold up under the statute of frauds. The appellate court disagreed, reasoning that the assignment identifies the county, survey, block, and section of the described land, which it held was sufficient to identify the property with reasonable certainty.

About the Authors

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SCOTX on Time Measurement: A 1-Day Difference Could Impact $180M in Damages

Apache Corp. v. Apollo Expl., LLC, No. 21-0587, 66 Tex. Sup. Ct. J. 744, 2023 Tex. LEXIS 366 (Apr. 28, 2023)

By: Austin W. Brister

In this case, the Texas Supreme Court was faced with a complex, multi-layered dispute revolving around the interpretation of a large ranch lease and several materially identical purchase and sale agreements with drilling commitments and re-assignment obligations. Primary issues involved were (1) how to calculate when a lease terminated, (2) whether a re-assignment obligation expanded to all of Apache's interest or only each seller's respective interest in the lease, and (3) how to calculate the "back-in trigger" or "project payout," and (4) whether the trial court properly excluded the appellants' expert witness.

Lease Termination Date

The bulk of the opinion focuses on when the subject lease partially terminated. The parties agreed that the lease partially terminated at the end of 2015, but they disagreed as to whether that partial termination occurred on December 31, 2015 or the next day on January 1, 2016. This one-day difference was material, because the re-assignment obligations under the purchase and sale agreements were measured by the calendar year. Apache was required to submit an annual drilling commitment by Nov. of each year, covering the next calendar year. If that commitment would result in lease termination, then that triggered Apache's re-assignment obligation at that time.

Thus, a one-day difference as to when the lease terminated had a full calendar year impact on the potential re-assignment obligation. If it expired December 31, 2015 then Apache's alleged re-assignment obligation arose as part of its 2015 drilling commitment due in November of 2014. However, if it expired January 1, 2016 then the alleged re-assignment obligation arose as part of its 2015 drilling commitment due one full year later.

Given that oil prices plummeted over that one-year span, Apache claimed that upwards of $180 Million in potential damages rode on the answer to whether the lease expired on New Year's Eve of 2015 or New Year's Day of 2016.

The Lease provided for an effective date of January 1, 2007, "from which date the anniversary dates of this Lease shall be computed." The Lease also indicated that the lease had a primary term of "three years from the effective date." The lease also contained a unique continuous development clause, under which the lease was divided into three equal "blocks" and each block could be maintained by conducting sufficient continuous operations "on each block each year after the expiration of the Primary Term."

The Court held that, because the lease measured time periods "from" an effective date, the termination date was governed by a default, common law rule for contracts that measure time "from" or "after" a specified measuring date. In addition, in the Court's view, the lease's reference to "anniversary dates" further indicated the parties intended to follow that default common law rule. Under that rule, "the measuring date—the date 'from' or 'after' a period is to be measured—is excluded in calculating time periods. For periods of years, therefore, the period ends on the anniversary of the measuring date, not the day before the anniversary." As an example, the Court indicated that "a period measured in years 'from' or 'after' June 30 (the measuring date) will end on a future June 30, not a future June 29." In this case, that mean the lease expired on January 1, 2016.

The Court indicated that this rule does not apply where a contract does not measure periods "from" or "after" a given date. Moreover, this rule also will not apply where parties have departed from the rule.

How can parties depart from this default, common law rule? According to the Court, "parties may freely depart from [the default rule] by demonstrating a ***clear contrary intent*** within their agreement." Sprinkled throughout the opinion are hints as to how parties might deviate from this rule:

—Specifying a date certain that the period would end;
—Specifying that the effective date is to be included in calculating the time period;
—Specifying that the term is to last for a period of years "and no longer;"
—"includ[ing] something…that, at a minimum, is clearly incompatible with the default rule, amounting to displacement by necessary implication."
—Expressly describing how the date will be calculated, either through "a myriad of other ways to clearly measure time," or other "bespoke methods."

Ultimately, the Court indicated the question is to be determined from the intent as expressed within the instrument as a whole, and that there are no particular formations or magic phrases.

The Court stated that "courts will enforce any lawful agreement regarding the calculation of time without requiring any particular formulation or magic language." However, the Court stated that "clarity" is required in order to "preclude[] post hoc efforts to rewrite contracts … under the guise of ambiguity."

Turning back to the lease at issue in this case, the Appellants had three primary arguments as to why they believed the lease should not be governed by the general rule. The Court rejected each of those arguments.

First, appellants argued that a January 1 effective date would suggest that the lease was intended to expire on December 31st, otherwise the primary term would actually run for three years and one day. The Court acknowledged that was technically accurate, but said they "fail to see why that matters." The Court suggested parties are not confined to using round numbers and, in the Court's view, parties add "and a day" in "all sorts of circumstances." The Court suggested the parties could have departed from the default rule by including the January 1st effective date in the calculation, by saying "the primary term was to last for three years and no longer," or they could have expressly set forth a December 31 end date.

Second, the appellants pointed to lease amendments that controlled continuous development during the 2011-2014 timeframe (before the 2015 year in dispute). Those amendments used the word "during" instead of "after," and they referred to a "calendar year" or specifically set a December 31 end date. The appellants presumably argued that the amendments reflected that the parties intended the terms to end on December 31. However, in the Court's view, the amendments used "markedly different durational language" which shows an intent to use dates that differ from the lease, and also shows the parties were capable of departing from the default rule when they wished to do so. The appellants also pointed out that one amendment stated that the lease was "currently" in effect as of "January 1, 2010," which they argued indicated an understanding that the primary term had already expired on December 31, 2009, and not on January 1, 2010 The Court rejected that argument, as it was a mere statement and not an amendment of the lease term, and because it did not "otherwise provide the clarity necessary to displace the default rule."

Third, the appellants pointed to the recorded lease memorandum, which stated that the lease's primary term would end on December 31 of 2009. The Court indicated that this did not control and was not even to be harmonized with the lease, because the lease memorandum itself stated that it was "subject to the conditions in the Lease," which the Court construed as "proclaiming that the lease controls whenever the two are in conflict."

Scope of Re-Assignment Obligation

Next, the Court turned to the appellants' argument that their individual purchase and sale agreements required Apache to offer back to each seller/appellant ***all*** of Apache's interest, not merely the respective interest that Apache purchased from each individual seller.

Specifically, the appellants/sellers argued that this should extend to and include a large percentage interest that Apache later acquired in an additional transaction with one of the other sellers that were not appellants.

The applicable provision of each PSA provided that the re-assignment obligation extended to "all of [Apache's] interest in the affected Leases (or parts thereof)[...]."

The appellants/sellers argued that "all" means "all" and therefore the obligation encompassed all of Apache's interest. The appellants also pointed out that other provisions distinguished between the interest purchased from an individual seller, from the collective interests purchased from all sellers. The appellants also argued that the purpose of the re-assignment obligation was to allow the sellers to take over and save a lease, which they argued would be difficult without a more expansive reading.

The Court rejected these arguments, pointing out that the re-assignment obligation was individually owed to each "Seller" and not collectively to the "Sellers." Therefore, in the Court's view, the obligation could not be read as extending to the entirety of Apache's interest, otherwise "multiple parties would each simultaneously have the right to the exact same interests." The Court pointed out how the underlying Joint Operating Agreement had several provisions providing guidance as to how to distribute interests in different situations, such as the non-consenting operations provisions, provisions for abandoning producing wells, renewal and replacement provisions, and an area of mutual interest provision. In the Court's view, the lack of such a provision in the PSA's re-assignment obligation reflected that the parties did not intend for the re-assignment obligation to require Apache to simultaneously offer to re-assign its entire interest to each seller. In that context, the Court construed the word "all" to refer to "all the interest that [each Seller] sold to Apache."

Calculating the "Back in Trigger" and "Project Payout"

Each PSA provided each seller "the right, but not the obligation," to "back-in for up to one-third (1/3rd) of the interests conveyed to [Apache...]," such right being "exercisable at Two Hundred Percent (200%) of Project Payout" which it defined as the "Back-In Trigger." In turn, the PSAs defined "Project Payout" as "the first day of the next calendar month following that point in time when the sum of [certain revenues] equals the sum of [certain costs]."

Apache argued that "200% of Project Payout" refers to the point when the specified revenues double the specified expenses. The Court construed the Sellers' argument as defining it as the point in time when specified revenues equal the specified expenses. The Court rejected that argument and sided with Apache.

The Court acknowledged that its interpretation, along with these definitions, resulted in "a rather awkward linguistic construction," because when the definition is ported into the text, "Back-In Trigger" would be literally read as "200% of the first day of the next calendar month" when certain revenues equal certain expenses. Presumably the focus of argument here was on the clumsy drafting that resulted in text referring to "200% of a day," rather than "the day when revenues are 200% of costs."

Expert Witness Issue

Finally, the Court turned to the issue of the seller's expert witness. The trial court had excluded the expert's testimony as to fair market value of the leases at issue, on grounds that his testimony assumed a December 31 lease expiration date whereas the trial court had held that the lease expired January 1. Again, while this was only a day in terms of lease termination, that meant a full year of difference in terms of Apache's alleged re-assignment obligation. Without significant explanation, the Supreme Court held that it agreed with the trial court regarding the lease expiration date, and concluded that the trial court properly excluded the expert testimony that was based on a different date.

Conclusion and Takeaways

Oil and gas lawsuits often depend upon the proper calculation of time periods, as oil and gas operations are frequently governed by overlapping layers leases and agreements, several of which often have independent or connected time periods. For instance, commencement or production dates can be critical in farmout agreements. As another example, joint operating agreements often set forth important time periods for commencing operations, providing notifications, proposals, and consent notices. Purchase and sale agreements often have important deadlines for due diligence, closing, notices, and post-closing risk allocation concepts. This case is notable in its guidance for calculating time periods, and as a case-study in how important these issues can be in a lawsuit.

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Conveyance of “Net Mineral Acres” – Subject to existing NPRI?

Brooke-Willbanks v. Flatland Mineral Fund, LP, No. 11-21-00105-CV, 2023 WL 162773 (Tex. App.—Eastland Jan. 12, 2023, no pet. h.)

By: Austin W. Brister

The oil and gas business can be filled with specialized lingo and terms of art. For instance, those in the business of buying and selling mineral and royalty rights often engage in deals using the phrases ‘net mineral acres’ and ‘net royalty acres.’ Those phrases can be helpful shortcuts in some circumstances, but it is not uncommon for buyers and sellers to have conflicting understandings as to what those phrases mean, and the implications they may bring. Indeed, in a recent appellate case, the grantor and grantee disagreed as to whether a conveyance of 70 ‘net mineral acres’ conveyed an interest free of a pre-existing NPRI.

In this case, the Eastland Court of Appeals reviewed a 2016 deed from Brook-Willbanks to Flatland, conveying “an undivided Seventy-Two (72) Net Mineral Acres” in a 320-acre tract of land in Martin and Howard Counties, Texas. The dispute focused on whether pre-existing NPRI interests burdened solely the interest of the grantor, or whether they proportionately burdened both the grantor and grantee.

The dispute largely centered on a subject-to clause in the deed, which read as follows:

> This conveyance is made subject to the terms of any valid and subsisting oil, gas and other mineral lease or leases on said land; and Grantor's [sic] have granted, transferred, assigned and conveyed, and by these presents do grant, transfer, assign and convey unto the Grantee, their heirs, successors and assigns, the above stated interest of Grantor's interest in and to the rights, rentals, royalties and other benefits accruing or to accrue under said lease or leases from the above described land. [...]
>
> Notwithstanding, it is the specific intent of this instrument to convey to Grantee the right to receive all bonuses, rents, royalties, production payments, or monies of any nature, including those in suspense, accrued in the past or in the future, associated with the undivided interest herein conveyed.

The appellate court first discussed the meaning of the term “net mineral acres.” The court found two recent CLE papers persuasive. One indicated “one net mineral acre is typically considered to equal the fee-simple mineral estate in one gross acre of land.” Another explained that, when “net mineral acres” are used the numerator will stay constant even though the denominator may change upon resurvey.

Turning to the “subject to” clause, the appellate court held that it clarified that Flatland took was taking its interest subject to the outstanding oil and gas lease, and that Flatland was receiving the same interest the grantor possessed.

The appellate court quoted the Texas Supreme Court’s opinion in ***Wenske v. Ealy***, 521 S.W.3d 791, 794 (Tex. 2017), stating “a severed fraction of the royalty interest-like [an] NPRI-generally would burden the entire mineral estate [...].” In the appellate court’s view, nothing in the deed expressed any contrary intent. Instead, the appellate court held that the subject-to clause expressed an intent to follow this principle, because it stated the intent was to convey “the above stated interest of Grantor's interest in and to the . . . royalties . . . accruing or to accrue under said lease or leases.” The court further emphasized that the subject-to clause expressed an intent for the grantee to receive royalties “associated with the undivided interest herein conveyed,” meaning the interest as existed at the time of the conveyance, which was burdened by previously received NPRIs.

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SCOTX Reviews Force Majeure Issues in Continuous Development Case

Point Energy Partners Permian, LLC v. MRC Permian Co.,
No. 21-0461, 2023 WL 3028100 (Tex. Apr. 21, 2023)

By: Chris Halgren

In the wake of COVID and Winter Storm URI, the phrase "force majeure" has practically become a household term. But handling a force majeure dispute is not for the wary, as a variety of issues and complications can arise. This recent case tackles the issue of causation and serves as a case study for careful drafting.

In this recent case, the Texas Supreme Court held that a lessee could not take advantage of a force majeure clause to extend the life of an oil and gas lease because the alleged force majeure event – a delayed drilling rig – was not the reason the lessee failed to timely commence drilling operations. Instead, according to the Supreme Court, the lessee failed to commence drilling operations because of an internal scheduling error. "After missing the deadline, the lessee discovered its scheduling error and only then invoked the lease's force majeure clause, referencing an allegedly qualifying event that had occurred nearly a month before the drilling deadline."

MRC erroneously schedules drilling deadline

MRC Permian, Inc. ("MRC") was the owner of oil and gas leases covering around 4,000 acres in Loving County, Texas with a primary term that ended in February 2017. Upon termination of the primary term, the leases provided that the leased premises would be subdivided into separate production units, with each well to be attributed to a separate unit and the leases terminating as to all lands not contained in a production unit. MRC could "temporarily suspend automatic termination" of the primary term by engaging in a continuous drilling program. Under that program, MRC was required to spud a new well every 180 days. Failure to strictly adhere to this deadline would result in the primary term expiring, the lease being automatically subdivided into production units for existing wells, and the leases terminating as to all acreage not included in a then-existing production unit.

In early 2017, MRC scheduled to spud a new well – the Toot 211 Well – which would be drilled in order to temporarily suspend the termination of the primary term, which was scheduled to expire in February 2017. To comply with the continuous development deadlines, MRC was required to spud its next well on or before May 21, 2017. However, after the initial schedule was prepared, MRC elected to reschedule the spudding of the Toot 211 Well until June 19, 2017 – a date which was almost a month *after* the primary term would expire absent compliance with the continuous drilling program.

About two weeks after the primary term expired on May 21, 2017, "MRC discovered its scheduling mistake." The Supreme Court noted that "MRC concedes it had mistakenly calculated June 19 as the expiration date" based on a mistaken reading of the applicable lease.

MRC invokes force majeure in attempt to avoid partial termination

Although missing the May 21 continuous development deadline, MRC claimed that the leases were maintained by their force majeure clause because the drilling rig needed for the Well was delayed at a prior drilling location on another lease. According to MRC, the rig planned to be used was "specially equipped to handle the high pressures" found in Loving County. On April 21, about a month before the MRC leases would expire, the rig MRC planned to use for the Well began experiencing "operational issues" while drilling a different well. These "operations issues" were later revealed to be wellbore instability issues that lasted approximately 30 hours.

The MRC leases contained a force majeure clause which provided, in part:

> **13. Force Majeure.** When Lessee's operations are delayed by an event of force majeure, being a non-economic event beyond Lessee's control, if Lessee shall furnish Lessor a reasonable written description of the problem encountered within 60 days after its commencement, and Lessee shall thereafter use its best efforts to overcome the problem, this lease shall remain in force during the continuance of such delay, and Lessee shall have 90 days after the reasonable removal of such majeure within which to resume operations ….

MRC provided written notice of the operational issues experienced by the rig prior to moving onto the lease's premises. The notice was sent within the 60-day deadline, but weeks after the primary term had already terminated.

SCOTX holds MRC could not invoke force majeure because event did not "cause" missed deadline

The Texas Supreme Court began its analysis with an in-depth review of force majeure clauses under Texas law. "Generally speaking, a force majeure clause is a 'contractual provision allocating the risk of loss if performance becomes impossible or impracticable, esp[ecially] as a result of an event or effect that the parties could not have anticipated or controlled.'" The Supreme Court explained that force majeure clauses can vary wildly in their definitions, scope, notice requirements, remedial-action requirements, and grace periods.

As with any other lease clause, the force majeure clause must be interpreted on the terms the parties chose. MRC argued that any "delay" was sufficient to trigger the force majeure clauses as written in its leases. Even though the delay here impacted the drilling of a well that was already (mistakenly) scheduled to commence untimely, MRC argued that the delay nevertheless operated to extend the life of the leases. The Supreme Court disagreed, stating that

> [w]hen viewed in isolation and taking an unduly literal interpretation, the phrase, "Lessee's operations are delayed by and event of force majeure" could be read to support MRC's position. But we do not read contractual phrases in isolation . . . The MRC Lease repeatedly yokes operations with lease deadlines, which, if not met, result in least termination . . . .

In this case, the Supreme Court found that there was no delay of an operation that would have perpetuated the leases because the spudding of the Toot 211 Well was not scheduled to occur until after the primary term expired. Because it would not have occurred timely, even absent any alleged delay, the force majeure clause could not apply to save the Lease.

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Reservation in Favor of Stranger Held Void; Estoppel-By-Deed Theory Not Supported by Evidence

Armour Pipe Line v. Sandel Energy, 2022 Tex.App.LEXIS 7265 (Houston [14th Dist.] 2022, no pet.)

By: Logan Jones

In this case, the 14th District Court of Appeals in Houston held that a purported reservation in favor of a stranger of title was void, and rejected the stranger's argument that the reservation could be enforced under an "estoppel by deed" theory because the court held the there was no language in assignment or related release that would support an estoppel theory.

At issue was a 1999 assignment of seventy-six oil and gas leases and thirteen wells from Armour Pipe Line Co. and various affiliates of the Cashman family, in favor of Sandel Energy, Inc.

The assignment purported to except and reserve an overriding royalty unto Armour. However, at that time, Armour was a stranger of title. Armour did not possess any title to the leases. Instead, Armour had acquired a lien on the interests, but nothing was filed of record reflecting Armour's acquisition of the liens, and there was no evidence that Armour owned any interest in the liens, or that Armour had attempted to foreclose on the liens.

At issue in this appeal was Armour's argument that, even if its purported reservation was void as an invalid reservation to a "stranger to title," it was nevertheless enforceable under the estoppel-by-deed doctrine.

The appellate court rejected Armour's theory, holding that the assignments did not contain recitals that would support Armour's claims. For instance, the court held that granting clause was not a statement that Armour owned interests in the leases, because it only purported to assign "Assignors' right, title and interest," meaning it only conveyed "whatever right, title and interest the Assignors may have had." The court held that the reservation clause did not support Armour's claim, because it was not a statement that Armour owns an overriding royalty interest, but instead was a reservation that purported to create a new right in favor of the grantor.

Similarly, the court held that the "exception" clause in the assignment did not support Armour's claim. That clause indicated that "Assignors hereby … EXCEPT … an overriding royalty interest…." The court held that this was not a statement that Sandel does not own an overriding royalty, but was instead an exception that operates to exclude some interest from the grant.

Armour also relied on alleged recitals from a second assignment. In that second assignment, executed about a year after the first assignment, Armour partially assigned its overriding royalty to Sandel, but only insofar as existing wells, and not as to future wells. The appellate court held that this assignment could not estop Sandel because Sandel only claimed its interest through the first assignment.

The court also examined a release that Armour executed along with the first assignment, under which Armour released all liens it held in any of the subject leases. The release recited that Armour owned a lien, and that it was being released as part of the first assignment. In the court's view, those recitals did not support Armour's theory, because they do not state that Armour owned an overriding royalty in the leases. Further, the court reasoned that Armour's status as a lienholder did not mean that Armour owned title in the leases, and there was no evidence that Armour ever foreclosed the lien or otherwise held any title to the leases.

Finally, the court reviewed the Cashman's claim that, if the purported exception and reservation in favor of Armour was ineffective, that mean the interest was then vested in the Cashmans, not in Sandel. The court rejected that argument, explaining that the Cashmans did not point to any authority indicating that property subject to an invalid reservation or exception remains with the grantor. Instead, in the court's view, existing precedent on that issue indicates that title to the interests passes to the grantee.

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Lay or Expert Testimony as to Lost Returns from a Well? Corpus Christi Holds the "Property Owner Rule" Inapplicable

Ellison v. Three Rivers Acquisition, 2022 Tex. App. LEXIS 9157 (Corpus 2022, no pet. h.)

By: Austin W. Brister

Expert witnesses can play a pivotal role in determining the outcome of a lawsuit, particularly in the oil and gas industry where technical and specialized information is often at the heart of a dispute. A recent Corpus Christi Court of Appeals case serves as a stark reminder that having the right testimony is only half the battle in some cases – ensuring that the witness is properly designated and qualified as an expert can be equally crucial.

In this recent case, the Corpus Christi Court of Appeals held that testimony from an oil and gas company's reservoir engineer, regarding the company's alleged lost production damages, was inadmissible because he was not designated as an expert. The oil and gas company argued that the "Property Owner Rule" allowed the non-expert testimony because it pertained to the value of the company's own property. The appellate court rejected that argument, holding that the value of mineral reserves is a "technical or specialized" matter that requires expert testimony.

This dispute was previously before the Texas Supreme Court. In 2021, the Supreme Court held that a boundary line stipulation was valid and enforceable, and that the neighboring lessee ratified it through by signing and returning a related letter.

This latest appellate decision, on remand, addresses a variety of issues. The main issue addressed in this article pertains to the jury's award of $492,551.39 in lost profits to Concho arising out of the alleged failure to recognize the boundary stipulation and ratification. The trial court's judgment omitted lost profits damages notwithstanding the jury's verdict.

On appeal, Concho argued that there was sufficient evidence to support the jury's award, pointing to detailed testimony and historical written analysis provided by Concho's reservoir engineer.

The appellate court affirmed the trial court, reasoning that the engineer was not designated as an expert witness and his opinions were not disclosed in discovery — two requirements pertaining to expert witnesses.

Concho argued that the "Property Owner Rule" affords an exception, allowing lay witnesses the ability to provide opinion testimony on the value of their own property.

The appellate court again disagreed with Concho, noting that the value of mineral reserves must be proven by expert testimony, and holding that "the Property Owner Rule does not extend to matters 'that are of a technical or specialized nature' such as the value of mineral reserves." Because Concho had no expert evidence on the issue of lost profits, the appellate court held that the trial court did not err in disregarding the jury's findings as to lost profits.

This case emphasizes the critical role expert testimony can play in oil and gas litigation. Securing the right testimony is just one aspect of the challenge; it is also critical to plan ahead to ensure the evidence is properly admissible. After all, obtaining the best damages testimony does little good if it is not admissible at trial.

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SCOTX Holds that Release of Claims as to "Predecessors" Did Not Include "Predecessors in Title"

Finley Res., Inc. v. Headington Royalty, Inc., No. 21-0509, 2023 Tex. LEXIS 406 (May 12, 2023)

By: M. Alejandra Salas and Austin W. Brister

It is not uncommon for attorneys, or parties alike, to treat settlement discussions as being concluded with only ministerial acts remaining once key traded terms have been drafted and agreed upon. This sometimes results in the overlooking of what may be considered more boilerplate or generic terms of the settlement, such as mutual release provisions.

However, settlements should not be drafted casually. Attention should be paid to miscellaneous or boilerplate provisions as well. Release provisions specifically can present a critical danger zone and should be carefully reviewed and drafted to ensure that they reach the proper intended scope. Too broad, and they may release claims or parties not intended to be released. Too narrow, and they may not fully and finally resolve the claims and issues intended to be settled.

This recent case from the Texas Supreme Court illustrates how parties, and non-parties alike, can have differing views as to the scope of release provisions. In this case, the Court reviewed a mineral exchange agreement that was entered into between a prior lessee and a top lessee. The agreement contained a release provision that extended to claims against each company's "predecessors." At issue was whether the release provision extended to the parties' predecessors in title or only to their corporate predecessors. The Court interpreted the provision to refer only to the company's "corporate predecessors," and not the company's "predecessors in title".

The Court acknowledged that the word "predecessor" has several meanings, some of which are quite broad, and that the word is often used in reference to "predecessors in interest." It also emphasized, however, that context within the agreement is significant in determining which specific definition is intended. In the context of the mineral exchange agreement, the Court found that the grammatical use of the word referred to the entities released and not the tract of land at issue, signaling a relation to corporate predecessors, and not predecessors in title.

Further, taking a close look of the release provision at issue, the Court noted that the word "predecessors" appeared in a laundry list of words that named categories of class members that were being released (i.e., the release applied to the company's "affiliates and their respective officers, directors, shareholders, employees, agents, predecessors and representatives"). The Court also observed that the categories of entities listed were authorized to act, in one way or another, on behalf of the other entities. According to the Court, that attribute would not apply to a mere predecessor in title. Rather, in the Court's view, the context showed that the parties meant for the word "predecessors" to mean corporate predecessors only.

Potentially of note, the Court's analysis begins by mentioning a threshold of clarity that must be met to release claims as to classes of persons that are not expressly named—they must be readily identifiable. The Court suggested that the threshold was not met with regard to predecessors in title, but it was met with respect to corporate predecessors. Also notable was the Court's discussion on the parties' sophistication and position during the negotiation of the mineral exchange agreement. Given the circumstances that gave rise to the parties' agreement, the lack of specific reference to the predecessor in title despite a looming threat of litigation was significant. Near the end of the opinion, however, the Court stressed that the threshold and external context of the mineral exchange agreement did not lead to its conclusion, and that its conclusion was instead based on its observations regarding "linguistic and grammatical context."

Although the release of claims is a useful tool in resolving disputes, such a provision will only have the intended effect if it is thoughtfully negotiated and drafted to fully protect each party's rights and interests.

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Exculpatory Clause Held Not to Cover Liabilities Knowingly Incurred Without Consent

Bachtell Enterprises, LLC v. Ankor E&P Holdings Corp., No. 14-20-00544-CV, 2022 Tex. App. LEXIS 3555, 2022 WL 1670772 (Tex.App.—Houston [14th Dist.] May 26, 2022, pet. denied)

By: Austin W. Brister

Exculpatory provisions are important considerations in JOAs. They can provide protection from certain claims and liabilities as an inducement to serve as the operator. But ensuring the clause does not extend too far is perhaps easier said than done.

In this case, Houston's 14th Court of Appeals held that the exculpatory clause in a JOA did not exonerate an operator from claims of knowingly assigning unauthorized charges to the nonoperators. This case is notable in its analysis of *Reeder v. Wood County Energy, LLC*, 395 S.W.3d 789 (Tex. 2012). In the appellate court's view, the case is one of first impression, addressing "whether 'activities' [in an exculpatory clause] is so broad as to protect an operator from any breach of contract so that the operator can have no liability for breach of any contractual provision, absent willfulness."

This case involved a JOA similar to the 1989 form. The operator, Ankor, entered into a deal with a third party, CDM Max, for the construction of a gas production plant. Ankor sent the nonoperators an AFE for $385k to purchase a plant site, but Ankor stated that CDM would then bankroll construction and own the gas plant. Ankor said this structure would "eliminate[] the need for the [nonoperators] to provide capital for construction." The non-operators approved and paid as requested.

However, after the plant was constructed, Ankor informed the nonoperators that CDM would be retaining all plant revenue until the construction costs, operating costs, and fees were paid off, and then Ankor billed the balance of $1.6 Million to the non-operators. The nonoperators refused to pay and demanded to see the agreement with CDM. Ankor refused, claiming it was confidential. Ankor filed suit against the nonoperators for failure to pay, and the nonoperators counterclaimed for fraud, money had and received, and breach of the JOA. A jury found that both Ankor and the nonoperators failed to comply with the JOA, that Ankor committed the first material breach, and that Ankor's breach was not the result of "willful misconduct."

Ankor did not dispute that it breached the single expenditure limit within the JOA, which required consent to undertake a project in excess of $50,000. However, Ankor argued that the JOA's exculpatory clause exonerated it from any liability. The exculpatory provision was largely similar to the version contained in the 1989 Model Form JOA. It indicated that the operator was required to "conduct its activities under [the] Agreement" as a reasonably prudent operator, but that it would not be liable to nonoperators "for losses sustained or liabilities incurred, except such as may result from willful misconduct."

The court disagreed with Ankor, holding the exculpatory clause did not relieve Ankor from liability for knowingly assigning unauthorized charges to nonoperators. The court acknowledged that *Reeder v. Wood County* involved a similar exculpatory clause, and that *Reeder* held that the operator was exempt from liability for all of its "activities under the agreement" including an alleged breach of the JOA for failure to maintain leases. However, the appellate court held that *Reeder* was not properly extended to this case because, in the appellate court's view, *Reeder* did not hold that "activities" encompasses all intentional breaches of the JOA.

In the court's view, exculpatory clauses are intended to relieve the operator from liabilities "in the performance of the contract," but not "for offensive use to impose liabilities knowingly incurred without consent." Also, exculpatory clauses are intended to cover liabilities caused by "ordinary negligence," and "[n]o precedent requires us to extend that protection further than negligent injury." The court also noted its duty to construe contracts from a utilitarian standpoint and to avoid unreasonable constructions.

The court also explained that the clause must be read in light of other provisions, briefly pointing to provisions indicating that parties are only responsible for their own obligations, that the operator is not the agent of the non-operators, that consent was required for this project, and that Ankor was only permitted to withhold revenues upon notice of a delinquent payment. Each of these would be rendered largely meaningless by Ankor's interpretation.

This case is notable in its limited reading of exculpatory language similar to the 1989 JOA. This language is often troublesome to non-operators following the *Reeder* decision, and this case may help shed light on the proper application.

THE GRUBB REPORT

You're In a Lawsuit, What's Next? Experts.

Five Things to Know About Using Expert Witnesses

By: William K. Grubb

Typically, testifying experts are not designated for months, if not years, into litigation. As a result, they can be an afterthought for a client involved in a new litigation matter. However, thinking through expert needs early can pay dividends. Here are five things you should keep in mind when assessing potential expert needs.

1) Timing is Important

Especially in the oil & gas/energy industries , certain experts are in high demand. Top quality experts often have case commitments spanning years into the future. If you need an expert, chances are the opposing party has a similar need. This can often lead to a "race" to retain the premiere expert in a certain field. Locating and retaining the right expert early (even pre-filing in certain instances) can have dramatic consequences on the course of litigation. Thus, if you or your company know that litigation will likely require expert testimony, an early conversation with litigation counsel about experts is important. Outside counsel can begin working quickly to identify and retain the right expert.

2) Don't Discount the Value of a Consulting Expert

When clients hear "expert," they often think of a testifying expert. However, consulting experts (those who do not testify) can be very important. In cases with complex data, obscure subject matter, or large investigative needs, consulting experts can be extremely valuable. For example, if you or your company's case will require frequent analysis of complex data, a consulting expert can help lessen the burden on your operational staff's time. Instead of litigation counsel burdening your in-house team with constantly pulling and analyzing data, litigation counsel can work with your consulting expert. This frees up your team to focus on projects and tasks that help your business. In other instances, a consulting expert can help you or your company gain an informational advantage earlier in a case. Additionally, matters reviewed by consulting experts are often shielded from discovery. This can allow a consulting expert to review a larger scope of information with less of a concern about creating discoverable material that may harm your case.

3) Defining an Expert's Scope Can Help Save Time and Money

Experts can be expensive. Good experts want to make sure they do not miss anything in their analysis. Thus, defining an expert's scope and providing them with the right information not only saves time, but also money. Spending front-end time gathering and organizing information that an expert will need is typically well worth it. An expert that is handed an assortment of unorganized information will be required to spend time (and your money) organizing the information *before* they get to substantive analysis.

4) Seemingly Simple Things Can Require Expert Testimony

Generally speaking, most future projections or models of past losses require expert testimony. Thus, although companies routinely project future profits, past losses, or the value of a particular client or customer, expert testimony may still be necessary. By way of example, a well credentialed financial analyst or CFO may be surprised to learn they need an expert for calculations they routinely make as a part of their day-to-day business. However, matters like lost profits damage models are typically the subject of court scrutiny. Business standards and legal standards can vary, sometimes substantially. A company's internal projection process may not be sufficient to withstand legal scrutiny. Accordingly, it's important to talk through even the simple things with litigation counsel before it's too late.

5) Winning the "Battle of the Experts" Can Be Important, But It's Not Everything

Experts are frequently hyper-focused on a particular issue. That issue is often of critical importance to the case. However, an expert's testimony rarely touches every issue in a case. For instance, an expert may be focused on damages because liability issues are lightly contested. However, clients and trial teams cannot let the time and work required for good expert testimony distract them from meeting other legal burdens (no matter how insignificant they seem). For example, I have seen cases where an expert's focus on his or her important issue creeps into the case writ large. This can lead to negative effects like inadvertently taking inconsistent positions. Thus, regardless of the strength of an expert, it is important to have the right litigation team in place to keep their eyes on the bigger picture. Experts often go "into the weeds" on particular issues. But having the right litigation counsel helps make sure the ultimate decision maker (whether a judge or jury) is presented with a consistent and well-rounded picture of the case.

About the Author

William K. Grubb *is a partner in McGinnis Lochridge's Houston office. Will is a commercial litigator with experience representing clients in energy, oil and gas, and other industries. Will has represented some of the world's largest energy companies, both publicly traded and private, on complex litigation matters. He strives to provide his clients with thorough but practical advice. Will prides himself on being able to analyze complex issues and explain them to his clients, courts, and opposing lawyers in a manner that provides a clear path to a positive outcome.*

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